91-1032

No.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

In re: EMILIO J. LAGUNA, JR.
and CYNTHIA LAGUNA,

Debtors,

SHEARSON LEHMAN MORTGAGE CORPORATION,

Petitioner,

vs.

EMILIO J. LAGUNA, JR.
and CYNTHIA LAGUNA, Debtors;
LAWRENCE J. LOHEIT, Trustee,

Respondents.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

THOMAS J. HOLTHUS
Counsel of Record
SHAPIRO & MILES

5 Hutton Centre Drive, Suite 1050
Santa Ana, California 92707
(714) 432-9014

Attorneys for Petitioner
SHEARSON LEHMAN MORTGAGE CORPORATION

Lawyers Brief Service • Appellate Brief Printers • (213) 383-4457 • (714) 720-1510

QUESTION PRESENTED FOR REVIEW

Did the Ninth Circuit Court of Appeals err in affirming the Bankruptcy Court's Order which confirmed a Chapter 13 plan over the objection of a secured creditor/home-mortgage lender where the plan failed to provide postpetition interest on a prepetition oversecured claim?

PARTIES TO THE PROCEEDING

Petitioner and all Respondents are named in the caption and were also parties before the United States Ninth Circuit Court of Appeals. A notice complying with Rule 12.4 of this Court will be served on each of the parties to the proceeding below; namely, the Respondents shown in the caption.

LISTING OF PARENT COMPANIES AND SUBSIDIARIES PURSUANT TO SUPREME COURT RULES, RULE 29.1

Pursuant to Rule 29.1, Petitioner lists the parent companies and subsidiaries, of SHEARSON LEHMAN MORTGAGE CORPORATION:

Parent Corporation: SHEARSON HOLDING INCORPORATED which is held by SHEARSON LEHMAN BROTHERS, INCORPORATED

Subsidiaries: Shearson Lehman Hutton Trust Deed Services, Incorporated; Shearson Lehman Hutton Insurance Services, Incorporated

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EMILIO J. LAGUNA, JR.
and CYNTHIA LAGUNA, Debtors;

LAWRENCE J. LOHEIT, Trustee,

Respondents.

PETITION FOR WRIT OF CERTIORARI

Petitioner, SHEARSON LEHMAN MORTGAGE CORPORATION, respectfully petitions for a Writ of Certiorari to review the judgment of the United States Court of Appeals for the Ninth Circuit.

I.

OPINIONS DELIVERED BY LOWER COURTS

Petitioner filed an appeal from the Bankruptcy Appellate Panel Opinion to the United States Court of Appeals for the Ninth Circuit. The Ninth Circuit opinion is officially reported at 944 F.2d 542 (9th Cir 1991), a copy of which is attached to Appendix A.

Petitioner appealed the final Order of the Bankruptcy Court to the Ninth Circuit Bankruptcy Appellate Panel. In a split decision, the Bankruptcy Appellate Panel affirmed the Bankruptcy Court's ruling and denied postpetition interest to secured creditors on a prepetition claim. The Bankruptcy Appellate Panel opinion is officially reported at 114 B.R. 214 (9th Cir. BAP 1990). A copy of the Bankruptcy Appellate Panel opinion is attached to Appendix B.

The United States Bankruptcy Court, Eastern District of California confirmed the Debtor's Chapter 13 petition over the objection of petitioner. The Bankruptcy Court Order Confirming the Debtors' Plan entered January 13, 1989, as well as a copy of the Court Transcript dated October 25, 1988 are attached to Appendix C and D respectively.

II

STATEMENT OF JURISDICTION

This Court has jurisdiction pursuant to 28 U.S.C. Section 1254(1) to review the final decision of the Ninth Circuit Court of Appeals, filed on September 11, 1991.

This Petition For Certiorari is also being filed pursuant to Supreme Court Rules 13.1 and 13.4.

III
CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case involves the following constitutional provisions, statutes, and regulations, which are fully reprinted in the Appendix: 11 U.S.C. Sections 506(b), 1322(b)(2), 1322(b)(3), 1322(b)(5), 1325(a)(5)(B)(ii), and the Fifth Amendment of the United States Constitution.

IV
STATEMENT OF THE CASE

A. Brief Nature Of The Case And Procedural Background

EMILIO J. LAGUNA, JR. and CYNTHIA LAGUNA ("Debtors"), filed their Petition For Relief under Chapter 13 of the Bankruptcy Code on or about August 25, 1988. Secured Creditor, SHEARSON LEHMAN MORTGAGE CORPORATION ("Shearson") held a Promissory Note ("Note") dated August 1, 1986 in the principal amount of $79,510.00, secured by a first Deed of Trust ("Deed of Trust") of the same date upon Property generally described as 2506 Loyola Drive, Davis, California 95616. The Deed of Trust was security on the Debtors' principal residence.

On October 21, 1988, the Bankruptcy Court, over Shearson's objections, confirmed the Debtors' proposed Chapter 13 Plan. The Bankruptcy Appellate Panel, in a

split decision, affirmed the Bankruptcy Court's Order. The Ninth Circuit Court of Appeals then followed suit.

B. Statement Of Facts

The relevant facts are not in dispute. On August 25, 1988, the Debtors filed their Petition for Relief under Chapter 13 of the Bankruptcy Code. At that time, the Debtors were six monthly payments in arrears on the Note secured by the Deed of Trust owing to Shearson. The total amount needed to reinstate the prepetition delinquencies was $5,516.31. The unpaid principal balance due and owing to Shearson at that time was $78,870.43. The Debtors did not dispute that Shearson was an oversecured creditor.

On August 25, 1988, the Debtors filed their proposed Chapter 13 Plan ("the Plan"). The Plan failed to pay all payments that were then due and owing to Shearson, but instead, proposed to cure the prepetition arrearages over a period not to exceed 36 months; however, it failed to provide for payment of interest on Shearson's secured claim to compensate Shearson for the present value of its oversecured claim based upon the Debtors' deacceleration of Shearson's Note.

On September 30, 1988, Shearson filed its Objections to the Proposed Chapter 13 Plan and Confirmation thereof since it failed to provide postpetition interest on the prepetition arrearages on Shearson's secured debt.

On or about October 14, 1988, the Debtors filed a Response to Shearson's objection, alleging that Shearson was not entitled to postpetition interest on the prepetition

arrearages. On October 21, 1988, Shearson filed its Reply to the Debtors' Response setting forth further points and authorities why Shearson was entitled to interest on its Secured Claim.

On October 25, 1988, Shearson's objection to confirmation of the Chapter 13 Plan was heard by the Bankruptcy Court, the Honorable Loren S. Dahl presiding. The Bankruptcy Court, apparently without considering the pleadings filed by either Shearson or Debtors, overruled Shearson's objections stating that the Court had previously ruled on other cases in which it had denied interest on arrearages owing to secured creditors (Appendix D, Transcript of Bankruptcy Hearing).

On January 13, 1989, the Bankruptcy Court entered its Order confirming the Debtors' Plan, which, in part, provided that "no interest shall be paid to creditors secured by real property except as required by the Promissory Notes held by such creditors." (Appendix C, Order of Bankruptcy Court). There is no dispute that Shearson's Note did not specifically provide for postpetition interest on arrearages in a Chapter 13 Bankruptcy Plan. However, Shearson claims it is entitled to interest pursuant to the Bankruptcy Code.

On July 20, 1989, the case was then brought before the Bankruptcy Appellate Panel. On May 18, 1990, the Bankruptcy Appellate Panel entered its split opinion, the majority confirming the Bankruptcy Court's ruling. (Appendix B, Order and Memorandum of Opinion of Bankruptcy Appellate Panel). The case was then appealed to the Ninth Circuit Court of Appeals.

On September 11, 1991, the Ninth Circuit Court of Appeals filed its decision affirming the orders of the lower Courts and denied Shearson's objections to the Debtors' Chapter 13 plan, and denied Shearson's right to postpetition interest on its prepetition oversecured claim. (Appendix A, Opinion of United States Court of Appeals for the Ninth District).

In the present case, there are no material issues of fact being disputed by the Debtors or Shearson. The only issue is the conclusion of law made by the Ninth Circuit Court of Appeals.

V
REASONS FOR GRANTING THE WRIT

A. CONFLICT AMONG THE CIRCUIT COURTS REGARDING WHETHER OR NOT A SECURED CREDITOR IS ENTITLED TO POSPETITION INTEREST ON A PREPETITION SECURED CLAIM MAKES THIS CASE A PRIME CANDIDATE FOR A WRIT OF CERTIORARI TO BE ISSUED.

This case provides the Court with an excellent opportunity to resolve the conflict between several Circuit Courts of Appeals as to whether a secured creditor in a Chapter 13 case can recover postpetition interest with regards to prepetition arrearages.

Some Circuits, including most recently the Ninth Circuit here, have determined that 11 U.S.C. Sections 1322

(b) (2) and (5) [1] prohibit the payment of interest on arrearages to a creditor holding solely a security interest in the debtor's principal residence unless the contract between the parties provides for such interest. *See, e.g., In re Capps,* 836 F.2d 773 (3rd Cir. 1987); *In re Terry,* 780 F.2d 894 (11th Cir. 1985); *In re Landmark Financial Services,* 918 F.2d 1150 (4th Cir. 1990).

On the other hand, the Sixth Circuit, has specifically held to the contrary. *In re Colgrove,* 771 F.2d 119 (6th Cir. 1985). In *Colgrove,* the Court held that a mortgagee holding an oversecured claim on a Chapter 13 debtor's personal residence was entitled to receive interest on mortgage arrearages which were to be paid under a Chapter 13 plan even in the absence of a specific clause in the loan agreement providing for interest on mortgage arrearages. The *Colgrove* Court reasoned that ordering

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[1] - U.S.C. Sections 1322(b)(2) and (5) provide in pertinent part:

The plan may---

* * *

(2) Modify the rights of holders of security claims, other than a claim secured only by a security interest in the real property that is the debtor's principal residence, or of holders of unsecured claims;

* * *

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim on which the last payment is due after the date on which the final payment under the plan is due.

that interest be paid on the arrearage did not constitute a modification of the loan agreement. Instead, the interest requirement was found merely to be incident to the "cure", as allowed through 11 U.S.C. Section 1322(b)(5). *In re Colgrove, Id.* at 122.

Secondly, the *Colgrove* Court held that 11 U.S.C. Sections 506(b) and 1325(a) were applicable which indicate that interest *is* allowable. (See also, dissent of Judge Russell, Appendix B)

Section 506(b) [2] sets forth:

> To the extent that an allowed secured claim is secured by property the value of which, . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs or charges provided under the agreement under which such claim arose.

Section 1325(a) provides in part:

> The court shall confirm a plan if -
>
> * * *
>
> (5) With respect to each allowed secured claim provided for by the plan --
>
> * * *
>
> (B)(i) The plan provides that the holder of such

---

[2] Unless otherwise noted, all sections refer to Title 11, United States Code.

claim retain the lien securing such claim, and
(ii) The value, as of the effective date of the plan, of property to be distributed under the plan of such claim is not less than the allowed amount of such claim.

Besides the Circuit Courts coming to diametrically opposite conclusions on the issue of allowing postpetition interest to secured creditors, Bankruptcy Courts, as well, have had divergent opinions on the issue of whether and which Code Sections are applicable and whether the legislative intent allows a secured creditor to receive postpetition interest on a prepetition oversecured claim. For example, the following Bankruptcy Courts have held that pursuant to the language of 11 U.S.C. 1322, payment of interest on arrearages is not required in the absence of a contract providing for such interest and/or would be a "modification" prohibited by Section 1322: *In re Carr,* 32 B.R. 343 (Bankr D.Ga. 1983); *In re Christian,* 35 B.R. 229 (Bankr.N.D. Ga. 1983); *In re Simpkins,* 16 B.R. 956 (E.D. Tenn. 1982); *In re Stamper,* 84 B.R. 519 (Bankr. N.D. Ill. 1988); *In re Rice,* 75 B.R. 47 (Bankr. D. Pa 1987); *In re Ward,* 73 B.R. 119 (Bankr. N.D. Ga. 1987); *In re Thompson,* 127 B.R. 717 (Bankr. D. Conn. 1991); *In re Adams*, 120 B.R. 517 (Bankr. E.D. Mo. 1990); *In re Penick,* 108 B.R. 776 (Bankr. W.D. Okl. 1989); *In re Morgan,* 106 B.R. 449 (Bankr. E.D. Va. 1989).

However, on the flipside, there are scores of decisions across the nation which have held for the proposition that a secured creditor in a Chapter 13 case can recover postpetition interest on prepetition arrearages based upon the theory, among others, that interest is required pursuant to Section 506(b) and 1325(a)(5)(B) to give the creditor the present value of his money. *See, e.g. In re*

Brown, 91 B.R. 19 (Bankr.E.D.N.Y. 1983); *In re Thomas*, 115 B.R. 305 (Bankr. E.D. Okla. 1990); *In re Catlin*, 81 B.R. 522 (Bankr. E.D. Minn. 1987); *In re Parker*, 125 B.R. 479 (Bankr. W.D. Tx. 1991); *In re Newberry Cafe*, Inc., 72 B.R. 478 (Bankr. E.D. Mass. 1987); *In re Busone*, 71 B.R. 201 (Bankr. E.D.N.Y. 1987); *In re Smith*, 125 B.R. 240 (Bankr. W.D. Mo. 1991); *In re Hall*, 117 B.R. 425 (Bankr. S.D. Ind. 1990); *In re McCall*, 57 B.R. 642 (Bankr. E.D. Pa. 1986); *In re Trigwell*, 67 B.R. 808 (Bankr. C.D. Cal. 1986); *In re Stratton*, 80 B.R. 44 (Bankr. W.D. Mich. 1983); *In re Van Gorden*, 69 B.R. 545 (Bankr. Mont. 1987); *In re Gin Castro*, 48 B.R. 662 (Bankr. R.I. 1985); *In re Corliss*, 43 B.R. 176 (Bankr. O. 1984). [3]

Clearly, with such a dichotomy as to the interpretation of Sections 1322(b)(2)and(5), Section 1322, Section 506(b), and Section 1325, and their interplay, if any, the Supreme Court should issue this Writ so as to explain these Code sections and to stop further inconsistent rulings.

B. THE SUPREME COURT HAS ALREADY DETERMINED INTEREST SHOULD BE PAID ON PREPETITION ARREARAGES, YET, THE NINTH CIRCUIT COURT OF APPEALS FAILED TO FOLLOW THIS RULING.

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[3] Some of the Bankruptcy Court decisions cited above, both for and against payment of interest, come from within the same circuits as those with Circuit Court opinions. The cases are cited only to show the vast divergent opinions among the courts.

This Court has already interpreted the pertinent Bankruptcy Code Sections and in particular has held that 11 U.S.C. Section 506(b) directs that postpetition interest *shall* be paid on all oversecured claims and that payment of postpetition interest on an oversecured claim need not be specified in the agreement between the parties. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 1030, 103 L.E.D. 2d 290 (1989).

In *Ron Pair,* this Court required that postpetition interest be paid on a federal tax lien in a Chapter 11 case. The same analysis applies to the present case since Section 506 applies equally to Chapter 13 and chapter 11 cases. 11 U.S.C. Section 103(a). (See dissent of Judge Russell, Appendix B)

Looking to the plain language of the Section 506(b), this Court held:

> The natural reading of the phrase [Section 506(b)] entitles the holder of an oversecured claim to postpetition interest and in addition, gives one having a secured claim created pursuant to an agreement the right to reasonable fees, costs and charges provided for in that agreement. *Recovery of postpetition interest is unqualified.* Recovery of fees, costs and charges, however, is allowed only if they are reasonable and provided for in the agreement under which the claim arose. Therefore, in the absence of an agreement, postpetition interest is the only added recovery available. *Ron Pair, Id.* at 1030. (emphasis added).

In the present case, the Ninth Circuit refused and failed to follow the holding in *Ron Pair* to require the

debtors to pay interest on Shearson's oversecured claim by asserting the Note and Deed of Trust did not require payment of interest on its claim. However, as is clear by the *Ron Pair* holding, whether a mortgage provides for the payment of interest on arrearages is irrelevant because the requirement that such payment be made is unqualified and exists independent of any contract provision. Petition for a review should be granted based upon the Ninth Circuit's refusal to follow *Ron Pair*.

C. THE NINTH CIRCUIT FAILED TO CONSIDER THE PLAIN LANGUAGE AND LEGISLATIVE HISTORY OF CHAPTER 13 AND SECTION 1322(b)(2) IN PARTICULAR, WHEN IT INCORRECTLY RULED SECURED CREDITORS WERE NOT ENTITLED TO POSTPETITION INTEREST ON PREPETITION ARREARAGES

The Ninth Circuit failed to look to the plain language of Section 1322(b)(2) which states that the plan may modify the "rights of holders of secured claims" other than a claim secured only by a security interest in the debtor's principal residence. In other words, the plan may not modify the *rights of a mortgagee* whose security interest is in the debtor's principal residence.

Section 1322(b)(2) does not state that a plan may not modify the "contract", as held by the Ninth Circuit. Rather, Section 1322(b)(2) states that a plan may not modify the "rights of holders" of the contract. Since paying interest to a secured creditor is a benefit (and a receipt of present value), its rights, as the holder of the security agreement, are not being modified.

Paying interest, while it may modify the contract does not modify the rights of Shearson. Of Course, not receiving payment of what is already due to Shearson does effect Shearson's rights. The only way to compensate Shearson is payment of interest through a present value calculation as required by Section 1325(a)(5)(B)(ii).

Additionally, the Ninth Circuit erred by applying Section 1322(b)(2) in a manner completely opposite to that which the legislature intended. The legislative history of Section 1322(b)(2) was reviewed at length in *In re Seidel,* 752 F.2d 1382 (9th Cir. 1985). The *Seidel* Court explained that in defining the word "modification", Congress intended to protect creditors wholly secured by home mortgages from *modifications made by debtors* (not creditors) that negatively impact creditors' rights. *In re Seidel, Id.* at 1384-1387. The *Seidel* Court found that the evolution of Section 1322(b)(2) showed a deliberate intent by Congress to insulate a certain subset of creditors -- those wholly secured by home mortgages. This Code section was enacted to provide *extra* protection to secured creditors secured by home mortgages and was in response to the perception that home mortgage lenders perform a valuable social service through their loans. *In re Seidel, Id.* 1386. (See Russell dissent, Appendix B)

Section 1322(b)(2) was enacted by Congress as a shield for secured creditors in a situation such as one like the case at bar; it was not meant to be used as a sword by a debtor against a creditor in an attempt to deny a mortgage lender the present value of its fully secured agreement. Ironically, pursuant to the holding of the Ninth Circuit here, all other creditors may receive interest except those whose security interest is in the debtor's residence,

a decision quite polar to Congress' intent. 11 U.S.C. Section 1325(a)(4).

D. THE IMPACT OF DISALLOWING POSTPETITION INTEREST ON PREPETITION ARREARAGES OF SECURED CREDITOR HOME MORTGAGE/LENDERS WILL HAVE INEQUITABLE AND FAR REACHING RAMIFICATIONS TO HOME MORTGAGE LENDERS ACROSS THE COUNTRY.

The number of annual bankruptcy filings has jumped 21.4 percent in the last year and a total of 140 percent in the last nine years. For the year July 31, 1990 through June 30, 1991, 880,399 bankruptcy cases were filed across the nation and of that large number, 244,192 were Chapter 13 cases.[4] For example, in regards to Shearson alone, it currently services over 1300 secured home loans in bankruptcy, approximately 850 of which are Chapter 13 cases. The present decision of the Court will effect nearly all Chapter 13 bankruptcy cases filed across the United States. Although the effect on each individual case may be relatively small, the total effect on home mortgage lenders is substantial.

Looking to the basic effect of the Ninth Circuit's ruling is appropriate. Not only would it be inequitable and against legislative intent to deprive home mortgage lenders of postpetition interest on prepetition arrearages, but it would be contra to the concise language of Section 1325 (a)(5)(b)(ii) which requires the payment of interest

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[4] For statistical data on bankruptcy filings, see *Administrative Office of the United States Courts.*

on arrearages in Chapter 13 cases when arrearages are not paid in full as of the effective date of the plan.

Section 1325(a)(5)(b)(ii) provides that a mortgagee must receive the present value of its claim if the claim is not paid in full. As explained by Bankruptcy Judge Barry Russell in his Bankruptcy Appellate Panel dissenting opinion, "The payment of interest is implicit in any present value analysis, which typically involves discounting a stream of future payments to its "present value" through the use of an appropriate discount rate. Under such an analysis, the payment of a specific amount over time must include the payment of interest in addition to the payment of principal (the specific amount at issue), in order to allow the stream of future payments, after discounting, to equal the same value as if payment of the full amount had been paid at time zero, i.e., the effective date of the plan." (Appendix B, Opinion of the Bankruptcy Appellate Panel, Dissenting Opinion).

All home mortgage lenders that are put in the unfortunate position of having money owed to them prior to a Chapter 13 bankruptcy being filed by a borrower/debtor will be placed in a more unjust position of only receiving what is presently due and owing to them trickled down over a span of three to five years. 11 U.S.C. 1322(c). Depriving creditors of interest on home mortgage arrearages "cured" under a debtor's plan will force such creditors to incur substantial losses since money due and owing today does not have the same value as money received in three to five years. The time value of money has been considered by Congress and deemed to be appropriate when payment will be made over a period of time. See 11 U.S.C. Sections 1124(3), 1129(b)(2)(A)(i)-(II), and 1325(a)(5)(b)(ii). It must also be remembered that

financial institutions must continue to pay interest to its depositors or investors for the use of this money while the lender receives nothing from the individuals benefiting from its use.

Further, in *In re Trigwell,* the court explained the rationale behind Section 1325(a)(5)(b)(ii):

> Section 1325(a)(5)(b)(ii) merely provides that if the debtor cures under Section 1322(b)(5) and provides for deferred payments in his plan, he should give the secured creditor what he deserves, the full present value of its allowed secured claim. *It does not make sense that Congress intended the exception to Section 1322(b)(2) (which benefits the home mortgage lender) to be used to single out and discriminate against the home mortgage lender as the only class of secured lender unable to receive interest on arrearages arising under a secured debt.* (emphasis added). *Id* at 810.

Clearly, maintaining the erroneous stance of the Ninth Circuit contradicts the legislative history, the plain language of the pertinent Code Sections, the holding in *Ron Pair* and common sense. In addition, the impact would be substantial since it would negatively effect the majority of home mortgage lenders that have arrearages owing in a Chapter 13 case. This could amount to the loss of millions of dollars each year.

CONCLUSION

For the foregoing reasons, Petitioner respectfully submits this Court should issue its Writ of Certiorari both to correct the conflict that exists between the Circuits regarding the payment of postpetition interest on prepetition arrearages and to review the Ninth Circuit's erroneous declaration and interpretation of the law in the present case.

December 9, 1991

Respectfully submitted,

THOMAS J. HOLTHUS,
Counsel of Record

SHAPIRO & MILES

Attorneys for Petitioners

APPENDIX A

FOR PUBLICATION

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

In re: EMILIO J. LAGUNA, JR.; CYNTHIA LAGUNA, *Debtors.*	
SHEARSON LEHMAN MORTGAGE CORPORATION, *Appellant,* v. EMILIO J. LAGUNA, JR.; CYNTHIA LAGUNA; LAWRENCE J. LOHEIT, Trustee, *Appellees.*	No. 90-15715 BAP No. EC-88-2107-PRAs (Bankruptcy No. 288-05581-A-13) OPINION

Appeal from the Ninth Circuit
Bankruptcy Appellate Panel
Perris, Russell, and Ashland, Judges, Presiding

Argued and Submitted
August 15, 1991—San Francisco, California

Filed September 11, 1991

Before: James R. Browning, Jerome Farris and Edward Leavy, Circuit Judges.

Opinion by Judge Leavy

SUMMARY

Bankruptcy

Affirming a judgment of the Bankruptcy Appellate Panel, the court of appeals held that the bankruptcy court's denial of a lender's request for postpetition interest on the debtors' prepetition arrearages was not erroneous, as the debtors' repayment was a cure of the default and not a modification of the underlying contract.

Appellant Shearson Lehman Mortgage Corporation (SLMC) was an oversecured creditor holding a promissory note and deed of trust on the debtors' principal residence and sole security for the mortgage obligation. After the debtors fell behind six months in their mortgage payments to SLMC, they filed for Chapter 13 relief. The bankruptcy court confirmed the debtors' plan proposing to resume all current payments to SLMC while paying off the prepetition arrearages over a period not to exceed 36 months. SLMC objected to confirmation of the plan, arguing that its failure to provide for postpetition interest on the prepetition arrearages violated 11 U.S.C. §§ 506(b), 1322(b)(2), and 1325(a)(5), as well as the fifth amendment. The Bankruptcy Appellate Panel affirmed.

[1] A debtor's act of filing a petition in bankruptcy bars his creditors, at least temporarily, from asserting any claims for unmatured interest on his unpaid obligations. **[2]** An exception to this general rule is that an oversecured creditor is ordinarily entitled to postpetition interest on his claim. This general right to postpetition interest is statutory and is based neither on the terms of any agreement between the parties nor on the status of the oversecured creditor's lien being either consensual or nonconsensual. **[3]** However, this right to postpetition interest is qualified by the interplay that exists with respect to modification and cure. **[4]** Under Chapter 13, a debtor may modify the rights of any secured creditor except

one whose claim is secured only by a mortgage on the debtor's principal residence. However, with respect to long-term debts in which the final payment falls due beyond the life of the plan, the debtor may cure any existing default. The Bankruptcy Code only requires that the cure of the default be accomplished within a reasonable time and that the regular mortgage payments be maintained. [5] Therefore, the court held that the BAP did not err by affirming the bankruptcy court's denial of SLMC's request for postpetiton interest on the debtors' prepetition arrearages, as their repayment was a cure of the default and not a modification of the underlying contract. In addition, because SLMC was not being deprived of its property, either in the form of principal or interest, since the cure merely reinstated the parties' original agreement, the court found that there was no fifth amendment violation.

COUNSEL

Thomas J. Holthus, Shapiro & Miles, Santa Ana, California, for the appellant.

Dan Vaughan and W. Scott de Bie, Law Offices of Max Cline, Sacramento, California, for the appellees.

OPINION

LEAVY, Circuit Judge:

This case presents a question of first impression in this Circuit involving the distinction between cure and modification in the context of bankruptcy law. For the reasons set forth below, we affirm the bankruptcy court's ruling in favor of the debtors.

FACTS AND PRIOR PROCEEDINGS

Emilio and Cynthia Laguna ("debtors") own a single-family dwelling which is both their principal residence and

the sole security for their obligation, represented by a promissory note and deed of trust, to Shearson Lehman Mortgage Corporation ("SLMC"), an oversecured creditor. The debtors filed a Chapter 13 petition in bankruptcy after falling six monthly installments behind in their mortgage payments to SLMC.

The debtors submitted a Chapter 13 plan that proposed to resume all current payments to SLMC while paying off the prepetition arrearages over a period not to exceed 36 months. SLMC objected to confirmation of the plan, arguing that its failure to provide for postpetition interest on the prepetition arrearages violated 11 U.S.C. §§ 506(b), 1322(b)(2), and 1325(a)(5) as well as the fifth amendment. The bankruptcy court overruled SLMC's objection and confirmed the plan, noting, *inter alia*, that neither the debtors' promissory note nor their deed of trust provided for any interest on arrearages. SLMC appealed to the Ninth Circuit Bankruptcy Appellate Panel ("BAP") which affirmed, with one judge dissenting, in a published opinion. *Shearson Lehman Mortgage Corp. v. Laguna (In re Laguna)*, 114 Bankr. 214 (9th Cir. BAP 1990). This timely appeal followed.

DISCUSSION

Because we are in as good a position as the BAP to examine a bankruptcy court's rulings, we review all decisions of the BAP *de novo*. *California State Univ., Fresno v. Gustafson (In re Gustafson)*, 934 F.2d 216, 218 (9th Cir. 1991).

SLMC argues that both 11 U.S.C. § 506(b), as recently interpreted by the Supreme Court in *United States v. Ron Pair Enters.*, 489 U.S. 235 (1989), and 11 U.S.C. § 1325(a)(5)(B)(ii), entitle it to postpetition interest on the debtors' prepetition mortgage arrearages. SLMC further argues that, because the debtors' Chapter 13 plan fails to provide for such interest, it violates both the fifth amendment and 11 U.S.C. § 1322(b)(2)'s prohibition against the modification of the rights of an

oversecured creditor whose sole security interest is in a debtor's principal residence. We reject SLMC's arguments.

[1] A debtor's act of filing a petition in bankruptcy bars his creditors, at least temporarily, from asserting any claims for unmatured interest on his unpaid obligations. *See* 11 U.S.C. § 502(b)(2).[1] This general prohibition against the assessment and collection of postpetition interest remains in effect until, *e.g.*, the bankruptcy stay is lifted or, in the context of a Chapter 13 proceeding, the debtor's repayment plan is confirmed by the court.

[2] An exception to this general rule is that an oversecured creditor, *i.e.*, one whose claim is secured by property belonging to the debtor that has a value greater than the claim asserted, *is* ordinarily entitled to postpetition interest on his claim. 11 U.S.C. § 506(b).[2] This general right to postpetition interest is statutory and is based neither on the terms of any agreement between the parties nor on the status of the oversecured creditor's lien being either consensual or nonconsensual. *Ron Pair Enters.*, 489 U.S. at 241, 245. Because the provisions of section 506 apply to Chapter 13 proceedings, *see* 11 U.S.C. § 103(a);[3] *Hougland v. Lomas & Nettleton Co. (In re Hougland)*, 886 F.2d 1182, 1183 (9th Cir. 1989) (section 506(a)), an oversecured creditor is ordinarily entitled to an allowance[4] for postpetition interest on its secured claim under Chapter 13.

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[1]11 U.S.C. § 502(b)(2) reads, in relevant part: "[I]f [an] objection to a claim is made, the court . . . shall allow such claim in such amount, except to the extent that . . . such claim is for unmatured interest[.]"

[2]11 U.S.C. § 506(b) reads, in relevant part: "To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim . . . ."

[3]11 U.S.C. § 103(a) reads as follows: "Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title."

[4]*See e.g.* 3 Collier on Bankruptcy ¶ 506.05 at 506-43 (15th ed. 1991) ("It is important to recognize that section 506(b) provides only for the *allowance* of postpetition interest . . . as part of a secured claim[; i]t does not require the current *payment* of such amounts.") (emphasis in original).

[3] While the above may state the general rule, an oversecured creditor's right to postpetition interest is qualified by, and must be understood in the context of, the interplay that exists between 11 U.S.C. §§ 1322(b) and 1325(a) with respect to modification and cure. *See Seidel v. Larson (In re Seidel)*, 752 F.2d 1382, 1383-86 (9th Cir. 1985) (discussing modification and cure under Chapter 13 as applied to secured creditor with interest in debtors' principal residence).

[4] Under Chapter 13 a debtor may *modify* the rights of any secured creditor *except* one whose claim is secured only by a mortgage on the debtor's principal residence. 11 U.S.C. § 1322(b)(2).[5] However, with respect to long-term debts in which the final payment falls due beyond the life of the plan (e.g., mortgages), the debtor may *cure any* existing default. 11 U.S.C. § 1322(b)(5).[6] The Bankruptcy Code only requires that the cure of the default be accomplished "within a reasonable time" and that the regular mortgage payments be maintained. *Id.*; *see also* 5 Collier on Bankruptcy ¶ 1322.09 at 1322-18 to 1322-19 (15th ed. 1991) ("Collier").

The only circuit-level case to address the question of modification versus cure in the context of a Chapter 13 oversecured mortgagee since the Supreme Court's decision in *Ron Pair Enters.* is that of *Landmark Fin. Servs. v. Hall*, 918 F.2d 1150 (4th Cir. 1990). In reaching its conclusion that the oversecured creditor was not entitled to postpetition interest on the debtors' prepetition mortgage arrearages, the Fourth Circuit

[5]11 U.S.C. § 1322(b)(2) reads, in relevant part: "[The debtor's] plan may . . . modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence[.]"

[6]11 U.S.C. § 1322(b)(5) reads, in relevant part: "[N]otwithstanding paragraph (2) of this subsection, [the debtor's plan may] provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any . . . secured claim on which the last payment is due after the date on which the final payment under the plan is due[.]"

carefully analyzed the distinction between a "cramdown"[7] modification of a secured creditor's rights and a cure of a debtor's default:

> [T]he principal components of a § 1325 cramdown are retention of the lien by the secured creditor and provision for the payment, during the life of the plan, *i.e.*, 3-5 years, of the full value of the secured claim. The cramdown route necessarily involves a modification of the creditor's rights with regard to such factors as number of payments and the rate of interest. The rights of a creditor whose claim is secured by a mortgage on a debtor's principal residence, however, may not be modified. * * * A cure essentially involves (1) satisfying any arrearages currently due, within a reasonable time, and (2) maintaining regular mortgage payments as they come due. The present value test of the cramdown section[ ] is irrelevant because the creditor's rights have not been modified. Whereas the cramdown route compensates the secured creditor with the present value of his collateral, the cure route reinstates the initial agreement which is the basis of the claim regardless of the value of the collateral.

Landmark Fin. Servs., 918 F.2d at 1154 (citations and internal quotations omitted).

[7]A court will confirm a debtor's Chapter 13 plan if it complies with certain statutory provisions (e.g., it "has been proposed in good faith and not by any means forbidden by law", 11 U.S.C. § 1325(a)(3)) and one of three conditions is met: (1) the secured creditor accepts it; (2) the secured creditor is allowed to retain his lien in the collateral and the present value of the payments to be made under the plan is not less than the allowed amount of the secured creditor's claim; or (3) the debtor abandons the collateral to the secured creditor. 11 U.S.C. § 1325(a)(5). It is the second of these options that is known as a "cramdown", because it can be forced onto a secured creditor without his consent.

This holding appears to represent the majority rule, both post-*Ron Pair Enters.*, *see e.g. In re Thompson*, 127 Bankr. 717, 719 (Bankr. D. Conn. 1991); *In re Smith*, 125 Bankr. 240, 241-42 (Bankr. W.D. Mo. 1991); *In re Adams*, 120 Bankr. 517, 519-21 (Bankr. E.D. Mo. 1990); *In re Siegfried*, 114 Bankr. 358, 359-61 (Bankr. N.D. N.Y. 1990); *In re Laguna*, 114 Bankr. at 216-18; *In re Penick*, 108 Bankr. 776, 779-80 (Bankr. W.D. Okla. 1989); *but see In re Parker*, 125 Bankr. 479, 482-83 (Bankr. W.D. Tex. 1991); *In re Hall*, 117 Bankr. 425, 427-29 (Bankr. S.D. Ind. 1990), as well as pre-*Ron Pair*. *See e.g. Appeal of Capps*, 836 F.2d 773, 777 (3d Cir. 1987); *Foster Mortgage Corp. v. Terry (In re Terry)*, 780 F.2d 894, 896-97 (11th Cir. 1985); *In re Kooker*, 106 Bankr. 233, 235-36 (Bankr. D. Nev. 1989); *In re Brown*, 91 Bankr. 19, 22 (Bankr. E.D. Va. 1988); *In re Stamper*, 84 Bankr. 519, 523 (Bankr. N.D. Ill. 1988).

The only reported circuit-level case to hold to the contrary is a divided Sixth Circuit opinion. *See Cardinal Fed. Sav. & Loan Ass'n v. Colegrove (In re Colegrove)*, 771 F.2d 119 (6th Cir. 1985). In that case the majority held that a provision in a Chapter 13 plan for payment of postpetition interest on mortgage arrearages did not constitute a modification of the underlying contract. *Id.* at 122-23. Judge Celebrezze argued in dissent that a mortgagor's right to cure a default did not require the payment of interest on mortgage arrearage payments which, by their very nature, already included interest. *Id.* at 124. No other circuit has adopted the majority's reasoning in *Colegrove*, and it has been strongly criticized by the leading bankruptcy treatise as well. *See* Collier ¶ 1322.09, at 1322-22 - 1322-23.

[5] We find the reasoning of the Third, Fourth, and Eleventh Circuits, as well as of Judge Celebrezze in his dissent, to be persuasive and adopt it as the rule of this Circuit. We therefore hold that the BAP did not err by affirming the bankruptcy court's denial of SLMC's request for postpetition interest on the debtors' prepetition arrearages, as their repayment

constituted a cure of the default and not a modification of the underlying contract. Because SLMC is not being deprived of its property, either in the form of principal or interest, since the cure merely reinstates the parties' original agreement, we find that there is no fifth amendment violation.

AFFIRMED.

APPENDIX B

FILED
May 18, 1990
Jed G. Weintraub, Clerk
U.S. BKCY. APP. PANEL
OF THE NINTH CIR.

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE NINTH CIRCUIT

In re:	)	BAP No. EC-88-2107
	)	
EMILIO J. LAGUNA, JR.	)	Bk. No. 2-88-05581-
and CYNTHIA LAGUNA,	)	A-13
	)	
Debtor(s).	)	
	)	
SHEARSON LEHMAN	)	
MORTGAGE	)	
CORPORATION	)	
	)	
Appellant,	)	OPINION
	)	
v.	)	
	)	
EMILIO J. LAGUNA, JR.,	)	
and CYNTHIA LAGUNA;	)	
LAWRENCE J.	)	
LOHEIT, Trustee,	)	
	)	
Appellees.	)	
	)	

Argued and Submitted on

July 20, 1989 at San Francisco,

California

Filed - MAY 18 1990

Appeal from the United States Bankruptcy
Court
for the Eastern District of California

Honorable Loren S. Dahl, Bankruptcy
Judge, Presiding

Before: PERRIS, RUSSELL and ASHLAND, Bankruptcy Judges.

PERRIS, Bankruptcy Judge

An oversecured creditor holding a security interest in debtors' primary residence, appeals from an order confirming the debtors' Chapter 13 Plan which proposed to cure pre-petition arrearages owed to appellant but which did not provide for interest on the arrearages. We AFFIRM.

FACTS

The relevant facts are not in dispute. Emilio and Cynthia Laguna (the "debtors") own a single family dwelling which is their principal residence and which is the sole security for the debtors' obligation to appellant, Shearson Lehman Mortgage Corporation ("Shearson"). Shearson is an oversecured creditor. Debtors were six monthly payments behind on their obligation to Shearson when they filed a Chapter 13 petition on August 25, 1988.

The debtors' Chapter 13 Plan proposed to pay the current payments to Shearson and to cure the pre-petition arrearages owed to Shearson over a period not to exceed 36 months, but did not provide for interest on the arrearages. Shearson objected to confirmation on the grounds that the Plan failed to provide for interest on the arrearages that is due over the term of the Plan under 11 U.S.C. § 1325(a)(-5).[1] Neither the note nor the deed of trust provided for interest on arrearages. The bankruptcy court overruled Shearson's objection and entered and order confirming the Plan on January 13, 1989. Shearson filed this timely appeal.

ISSUES

1. Whether an oversecured creditor, whose sole security is the debtors' principal residence, is entitled to post-petition interest on pre-petition arrearages that are cured under the debtor's Chapter 13 plan when neither the note nor the deed of trust provide for such interest.

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1 All references are to the Bankruptcy Code, 11 U.S.C. §§ 101 et. seq., unless otherwise indicated.

2. Whether the Fifth Amendment requires the payment of such interest.

STANDARD OF REVIEW

The issues on appeal are questions of law that are reviewed *de novo*. *See In re Patterson*, 86 B.R. 226, 227 (9th Cir. BAP 1988).

DISCUSSION

1. *Whether an oversecured creditor, whose sole security is the debtor's principal residence, is entitled to post-petition interest on pre-petition arrearages that are cured under the debtor's Chapter 13 Plan when neither the note nor the deed of trust provided for such interest.*

Shearson initially contends that it is entitled to post-petition interest on the pre-petition arrears under sections 506(b).[2] Section 506(b) determines the interest to be included as part of the allowed secured claim as of the date of confirmation rather than the interest to be paid on deferred payments under the Plan. *See In re Corliss*, 43 B.R. 176, 178 (Bankr. D. Or. 1984). This distinction

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[2] 11 U.S.C. Section 506(b) provides as follows:

To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is this greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

compels us to reject Shearson's argument that it should be allowed to recover post-confirmation interest on arrrearages under section 506(b).

Even if section 506(b) were pertinent to post-confirmation interest, it is doubtful that it would allow interest on arrearages in the absence of a contractual provision providing for such interest. Courts have generally disallowed interest on arrearages under section 506(b) unless there was a contractual basis for such interest. *See, e.g., In re Gincastro,* 48 B.R. 622 (Bankr. D.R.I. 1985). Shearson argues that the recent decision of *United States v. Ron Pair Enterprises, Inc.,* ____ U.S. ____, 109 S. Ct. 1026 (1989), implicitly overruled cases disallowing interest on arrearages in the absence of a contractual basis for such interest. In holding that postpetition interest may be allowed on oversecured nonconsensual lien claims under section 506(b), the Court in *Ron Pair* determined that the right to interest under section 506(b) is not limited to those instances where a secured creditor has a contractual right to such interest. We do not believe that *Ron Pair,* however, requires the allowance of interest on contract arrearages absent an appropriate contract provision. The allowance of such interest under section 506(b) would involve applying that section twice -- first to determine that arrearages are part of the unsecured claim [3] and then to determine that interest

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[3] Shearson's proof of claim listed, in addition to the unpaid principal, arrearages in the amount of $5,516.31. The arrearages apparently consist of unpaid principal and interest, late charges and attorneys' fees. The portion of the arrearages consisting of unpaid principal would be part of the allowed secured claim under the terms of the

should be allowed on the arrearages. Such allowance under section 506(b) would result in the compounding of interest [4] which is inconsistent with state law unless there in a contrary agreement. *See Cal. Civ. Code § 1916-2.* Absent a clear statutory mandate, to allow an oversecured creditor interest on interest when such allowance is contrary to state law would impede the bankruptcy goals of fostering financial rehabilitation and equitable distribution among creditors.

Shearson relies on section 1325(a)(5) as the second prong of its argument. Under section 1325(a)(5) as the second prong of its argument. Under section 1325(a)(5), when a secured creditor does not accept a plan and the debtor does not surrender the collateral to the creditor, the present value of property distributed under the plan must be no less than the allowed secured claim provided for by the

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loan documents. The portion of the arrearages consisting of the unpaid interest, late charges and attorneys' fees would be part of the allowed secured claim pursuant to section 506(b).

[4] Although there is no proof in the record, the fact that the default occurred in the second year of a 30 year note, suggests that the missed payments and consequently the arrearages consist primarily of interest, which was made part of the allowed secured claim under section 506(b). Requiring the payment of interest on the arrearages would therefore result in the compounding of interest.

plan. [5] See 5 *Collier on Bankruptcy* § 1325.04[4][b][iii] (15th ed. 1988) (hereafter "*Collier*"). When the plan proposes to pay an allowed secured claim by deferred payments, present value may be provided by proposing interest payments on the allowed secured claim over the course of the payment period. *See Id.* The heart of this dispute is whether sections 1322(b)(2) and (5) alter or are inconsistent with the possible allowance of such interest under section 1325(a)(5)(B)(ii).

As relevant to the issue before us, section 1322 (b)(2) prohibits the modification by a Chapter 13 plan of the rights of holders of "a claim secured only by a security interest in real property that is the debtor's principal

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[5] 11 U.S.C. Section 1325(a)(5) provides that a court shall confirm a chapter 13 plan if, *inter alia,* with respect to each allowed secured claim provided for by the plan --

> (A) the holder of such claim has accepted the plan;
> (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and
> (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
> (C) the debtor surrenders the property securing such claim to the holder.

residence." [6] *See In re Seidel,* 752 F.2d 1382, 1383 (9th Cir. 1985). Notwithstanding this prohibition, section 1322(b)(5) allows the plan to cure a default and maintain payments during the pendency of the Chapter 13 proceeding on any secured claim on which the last payment is due [7] There is a split of authority on the effect of these sections on the possible entitlement to interest under these sections.

Many courts, including the Third and Eleventh Circuits, have determined that sections 1322(b)(2) and (5) prohibit the payment of interest on arrearages to a creditor holding solely a security interest in the debtor's principal residence unless the contract between the parties provides

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[6] 11 U.S.C. Section 1322(b)(2) provides that a . . Chapter 13 plan may

> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

[7] Section 1322(b)(5) provides as follows:
(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on a ny unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.

for such interest. *See, e.g., In re Appeal of Capps,* 836 F. 2d 773 (3d Cir. 1987); *In re Terry*, 780 F2d 894 (11th Cir. 1985); *Collier* Paragraph 1322.09[4]. *Capps* reasoned that curing a default pursuant to section 1322(b)(5) was not a modification of the secured creditors rights in that the terms of the contract, with the exception of the injunction against foreclosure, remained in force. 836 F.2d at 776. Accordingly, the court determined that the present value test of section 1325(a)(5) was not applicable where a default is cured under section 1322(b)(5) because section 1325(a)(5) applies only to compensate secured creditors whose rights have been modified. *See also Collier* Paragraph 1322.09[4]; *In re Stamper,* 84 B.R. 519 (Bankr. N.D. Ill. 1988).

Terry determined that the payment of interest on arrearages under section 1325(a)(5) constitutes a modification that is prohibited by Section 1322(b)(2) when the contract between the parties did not provide for such interest. 780 F.2d at 896-97. *See In re Brown*, 91 B.R. 19, 22 (Bankr. E.D. Va. 1988); *Stamper,* 84 B.R. at 523. *Terry* further noted, similar to *Capps,* that section 1325(a)(5)(B) is intended to benefit those creditors whose rights may be modified and has no application in light of section 1322(b). 780 F.2d at 896-97.

Other courts, including the Sixth Circuit, have held that the payment of interest on arrearages is permissible under section 1325(a)(5) and is not barred by section 1322(b)(2) and (5), notwithstanding the fact that the contract between the parties does not provide for such interest. *See, e.g., In re Colgrove,* 771 F.2d 119, 122 (6th Cir. 1985). *Colgrove* determined that interest is allowable under sections 506(b) and 1325(a)(5) and such interest is "merely incident to the 'cure'" of section 1322(b)(5) rather

than an impermissible modification of the loan agreement. 771 F.2d at 122. *In re Catlin,* 81 B.R. 522, 524-25 (Bankr. D. Minn. 1987), in reaching the same result as *Colgrove,* determined that although sections 1322(b)(2) and (5) limit the extent to which the rights of certain secured creditors can be impaired under the Plan, they do not limit the rights and benefits conferred elsewhere in the Code (for example, sections 506(b) and 1325(a)(5)). *Catlin* further noted that sections 1325(a)(5) and 1322(b)(2) serve different but complementary purposes and are not inconsistent or contradictory. *Id. In re Trigwell,* 67 B.R. 808, 810 (Bankr. C.D. Cal. 1986), agreed that sections 1325(a)(5)(B) and 1322 (b)(2) and (5) were not inconsistent and indicated that it does not make sence for section 1322 (b)(2), which benefits the home mortgage lender, to be used to single out and discriminate against that lender as the only class of secured creditor who is unable to receive interest on arrearages under a secured debt. *Id.*

We believe that the authorities determining that the payment of interest on arrearages is not required in the absence of a contract providing for such interest are persuasive and consistent with pertinent Ninth Circuit authority. Section 1322(b)(2) prohibits the modification of the rights of creditors holding a security interest solely in the debtor's principal residence. Section 1322(b)(5) creates an exception to this prohibition by allowing the debtor to cure a default within a reasonable time an maintain payments on the secured debt. Requiring post-confirmation interest to be paid on interest under either section 506(b) or 1325(a)(5)(b) absent a contractual provision providing a right to such interest would constitute a prohibited modification as it would alter the rights and expectations of the parties under their contract. This modification is not, as is

suggested by *Colgrove* merely incident to the cure because the steps necessary to cure are defined by the contract and applicable non-bankruptcy law. *See Collier* Paragraph 1322.09[4]. In this case, neither the contract, nor applicable non-bankruptcy law requires interest to effect a cure. *See Cal.* Civil Code § 2924c(a).

The Court of Appeals for the Ninth Circuit has dealt with the concept of "cure without modification of the underlying claim in the Chapter 11 setting. *In re Entz-White Lumber and Supply, Inc.*, 850 F.2d 1338, 1340 (9th Cir 1988) (quoting *In re Taddeo*, 685 F.2d 24, 26-27 (2d Cir. 1982)) explained the concept of "cure" as follows:

> A default is an event which triggers certain consequences. Curing a default commonly means taking care of the triggering event and returning to pre-default conditions. The consequences are thus nullified. this is the concept of 'cure' used throughout the Bankruptcy Code.

Thus, cure means to restore the status quo which existed before the default. *Id.* Requiring the debtor to perform obligations which were triggered only by a default, such as requiring the payment of a post-default rate of interest, is inconsistent with the concept of "cure" and would completely eliminate the benefits of a cure as it would fail to nullify a significant consequence of default. *In re Southeast Co.*, 868 F.2d 335, 339 (9th Cir. 1989); *see Entz-White*, 850 F.2d at 1343. Similarly, in this case, allowing the payment of interest on interest, which would be inherent in paying interest on arrearages, would go beyond restoring the *status quo ante*, would eliminate the benefit of cure and would fail to nullify a consequence of the

default. The allowance of such interest, therefore, would not be incident to the cure.

We are also persuaded by the reasoning of *Capps* that 1325(a)(5)(B) is not applicable when there is maintenance and cure under section 1322(b)(5) because there is not modification of the secured creditors' rights. Similar to a determination that a cure under section 1322(b)(5) does no modify creditor's rights, a claim is considered unimpaired under Chapter 11 if the plan, *inter alia,* cures prepetition defaults and reinstates the debt. *See* section 1124(2); *see also Southeast Co., supra.* A Chapter 11 plan need not be crammed down on creditors who are not impaired by the plan. See sections 1129(a)(8)(B) and 1129 (b)(1). By way of analogy to Chapter 11, the cram down provisions of section 1325(a)(5)(B) are not applicable when the debtor utilizes section 1322(b)(5) to cure defaults and maintain payments.

Shearson argues that section 1322(b)(2) merely prohibits the modification of the rights of a holder of a claim secured by the debtor's principal residence and that conferring a benefit on the holder through the allowance of interest is not a modification of its rights. This contention is not well taken. By its terms, section 1322(b)(2) prohibits the modification of a mortgage holder rights, whether the modification is to its benefit of detriment.*In re Stratton,* 30 B.R. 44, 45 (Bankr. W.D. Mich. 1983). An example will illustrate the weakness of Shearson's Contention in this regard. Suppose the contract provided for interest on arrearages at the rate of 10% and the proper interest rate for interest under section 1325 (a)(5)(B)(ii) is the prevailing market rate. Under Shearson's argument, if the market rate is higher that 10% it would be allowed to recover the higher rate as a permissible modification. If, however, the

market rate is less than 10% an adjustment to the market rate would be an impermissible modification. Carrying the analogy to its next logical step, under Shearson's argument there would be no reason why it would not be entitled to a market interest rate on its entire claim since such a rate reflects present value. Congress did not intend that debtors be required to pay the higher of the market interest rate on the contract rate on claims secured solely by their principal residence. *See In re Brady,* 86 B.R. 166, 170 (Bankr. D. Minn. 1988). Such payment would be at odds with section 1322(b)(2)'s bar to modifying the rights of certain secured creditors.

In summary, we believe that the cases denying the right to interest on pre-petition arrearages in the absence of a contract providing for such interest are more persuasive and are consistent with Ninth Circuit authority explaining the concept of "cure". Sections 1322(b)(2) and (5) detail the treatment to be afforded to the holders of claims secured only by the debtors' personal residence. This treatment does not include interest on pre-petition arrearages unless the contract between the parties so provides. The possible allowance of such interest under sections 1325(b)(5) and 506(b) is inconsistent with the treatment afforded by sections 1322(b)(2) and (5)as it would be an impermissible modification of contractual rights.

2. *Whether the Fifth Amendment requires the payment of such interest.*

Shearson also argues, relying on *In re Metz,* 67 B.R. 462, 467 (9th Cir. BAP 1986), *aff'd* 820 F.2d 1495 (9th Cir. 1987),that a failure to pay interest on pre-petition arrearages would violate the Just Compensation clause of the Fifth Amendment to the Constitution. *Metz* determined

that a mortgagee's ability to accelerate a note for nonpayment was not a vested right protected by the Just Compensation clause and therefore the cure and reinstatement of the note at the original interest rate was not an unconstitutional taking where Plan provided for maintenance of payments and repayment of arrearages with interest.

Basically, *Metz* determined that the primary modification that was allowed by section 1322 (b)(2) and (5) -- the cure and reinstatement -- was not unconstitutional. Aside from that modification, if interest is not allowed under sections 506(b) or 1325(a)(5), the parties are left with the rights provided for by their contract. Because the contractual rights remain in place, with the exception of the cure and reinstatement, we do not see how and unconstitutional taking could occur. In addition, although the plan in Metz provided for interest on the arrearages, the Panel did not indicate that such interest was required to avoid a constitutional infirmity.

Even if Shearson's rights as a secured creditor are somehow impaired by the failure to pay interest, courts have uniformly held that the impairment, or even the avoidance, of a secured creditors rights by the Bankruptcy Code does not constitute an unconstitutional taking under the Fifth Amendment when the security interest arose after the enactment of the Code. *See, e.g., In re Thompson*, 82 B.R. 985, 988-89 (Bankr. W.D. Wisc. 1987) (application of the lien avoidance provisions of section 522(f) is not an unconstitutional taking when the security interest arose after the enactment of the Code); *compare United States v. Security Industrial Bank*, 459 U.S. 70, 78 (1982) (there is substantial doubt whether the application of the lien avoidance provisions of section 522(f) to a lien arising before the enactment of the Code comports with the Fifth

Amendment). In this case, Shearson's security interest was created after the enactment of the Code and any impairment of Shearson's rights inherent in denying interest on pre-petition arrearages pursuant to the Code is constitutional.

CONCLUSION

We determine that an oversecured secured creditor, who holds a security interest solely in the debtors' principal residence, is not entitled to post-petition interest on pre-petition arrearages that are cured under the debtor's Chapter 13 plan when neither the note nor the deed of trust provide for such interest. We also determine that the Fifth Amendment does not require the payment of such interest. Because we determine that there is no right to interest we do not address the appropriate rate of interest. For these reasons, we AFFIRM.

RUSSELL, Bankruptcy Judge, DISSENTING:

I dissent. Payment of interest on arrearages is required in a Chapter 13 case when the arrearages are not paid in full as of the effective date of the plan. 11 U.S.C. § 1325 (a)(5)(B)(ii). A plan cannot be confirmed if it provides otherwise.

Whether this mortgage provides for the payment of interest on arrearages is irrelevant because the requirement that such payment be made exists independent of any contract provision. The obligation to pay interest on arrearages is a statutory requirement contained in Section 1325(a)(5)(ii), which provides that a mortgagee must

receive the present value of its claim, [8] if the claim is not paid in full. The right to interest created by Section 1325(a)(5)(B)(ii), like the rights to interest Section under Section 506(b), [9] is not conditioned on the existence of a right to interest under the contract or under applicable bankruptcy law.

---

[8] The payment of interest is implicit in any present value analysis, which typically involves discounting a stream of future payments back to its "present value" through the use of an appropriate discount rate. Under such analysis, the payment of a specific amount over time must include the payment if interest in addition to the payment of principal (the specific amount at issue), in order to allow the stream of future payments, after discounting, to equal the same value as if payment of the full amount had been made at time zero, i.e., the effective date of the plan.

[9] Section 506(b)'s requirement that interest be allowed in certain situations is a statutory obligation that exists regardless of whether interest is otherwise allowed under the contract or applicable nonbankruptcy law. *United States v. Ron Pair Enters., Inc. (In Ron Pair Enters., Inc.),* 109 S. Ct. 1026 (1989).

Section 1325(a)(5)(B)(ii) is analogous to Section 506(b) and should be subject to a similar reading because it also creates an obligation that exists in situations regardless of whether a right to interest otherwise exists under any contract or applicable nonbankruptcy law.

The majority makes unwarranted assumptions that most of the arrearages are interest and apparently that there is something evil about compounding interest. However, we are dealing here only with the interest on the arrearages and not the interest on the principal. The rate to be paid on the note is an entirely different issue that is not now before this Panel.

The majority cites California Civil Code Section 1916-2 which merely provides that for a compounding of interest in California, there must be a provision in the contract. The right to interest which is the subject of this appeal originates from a federal statute and state law on interest is irrelevant to the interest rate under Section 506(b).

In this regard, the majority completely misses the point clearly made by the Supreme Court in *Ron Pair* that the interest provided for in Section 506 (b) is not the same as the interest specified under a contract. The majority would allow the debtor to use 1332(b)(2) to abridge rights given the creditor under Section 506(b) and Section 1325(a)(5)(B)(ii). In support of its position, the majority cites several cases that were decided prior to *Ron Pair*. If the Court in *Ron Pair* had held that Section 506(b) does *not* require allowance of interest on contract arrearages absent an appropriate contract provision, the effect of *Ron Pair* on the facts of this case might very well be different. However, I am bound by the holding of the Supreme Court in *Ron Pair* which clearly states otherwise:

The relevant phrase in § 506(b) is: "there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose".

"Such claim" refers to an oversecured claim. The natural reading of the phrase entitles the holder of an oversecured claim to postpetition interest.... Recovery of postpetition interest is unqualified.... Therefore, *in the absence of an agreement*, postpetition interest is the only added recovery available. *Ron Pair*, 103 L. Ed. 2d at 298 (emphasis added).

There is no conflict between such and interpretation of Section 1325(a)(5)(B)(ii) and Section 1322(b)(2). As the majority points out, Section 1322(b)(2) prohibits the modification of the rights of a holder of a secured claim, where the claim is "secured only by a security interest in real property that is the debtor's principal residence".

It has been argued that Section 1322(b)(2) bars modifications even if they benefit the secured creditor. The legislative history of Section 1322(b)(2) was reviewed at length in *In re Seidel*, 752 F.2d 1382 (9th Cir. 1985). In defining the meaning of the word "modification" the Ninth Circuit concluded that Congress intended to protect creditors wholly secured by home mortgages from modifications made by debtors that negatively impact creditors rights. *Id.* at 1394-87. However, there is no indication from the legislative history of Section 1322(b)(2) that Congress intended to prohibit modifications that benefit a creditor.

Therefore, Section 1322(b)(2) is clearly no bar to the applicable statutory provisions of Title 11, such Section 1326(a)(5)(B)(ii), which "modifies" a mortgagee's rights by placing limits on a debtor's ability to ignore the time value of money when providing for a secured creditor's claim in a plan. I would, therefore, reverse.

APPENDIX C

MAX CLINE
A PROFESSIONAL CORPORATION
510 BERCUT DRIVE, SUITE J
SACRAMENTO, CA 95814
TELEPHONE: (916) 442-4186

Attorney for Debtor(s)

UNITED STATES BANKRUPTCY COURT, EASTERN DISTRICT OF CALIFORNIA

Re:

EMILIO J. LAGUNA and CYNTHIA LAGUNA	CHAPTER 13 CASE NO. 288-05581-A-13
_____/	ORDER CONFIRMING DEBTOR(S) PLAN

The Debtor(s) having appeared at the Meeting of Creditors and Confirmation hearing pursuant to Sections 341 and 1324 of the Bankruptcy Code, The court finds as follows:

1. Written notice was provided pursuant to Rule 13203;

2. The plan complies with the provisions of Chapter 13 and other applicable provisions of the Bankruptcy Code;

3. All fees or charges required prior to confirmation have been paid;

4. The plan has been proposed in good faith and not by any means forbidden by law;

5. The value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than liquidated under Chapter 7; and

6. With respect to each allowed secured claim provided for by the plan, the holder of such claim has either accepted or is deemed to have accepted the plan, or in the alternative-

a. (I) The plan provides that the holder of such claim retain the lien securing such claim; and

(II) The value, as of the effective date of the plan, of the property to be distributed on account of such claim is not less than the allowed amount of such claim; or

b. The plan proposes to surrender the property securing such claim to the creditor.

IT IS THEREFORE ORDERED THAT:

1. The Debtor(s) plan is confirmed as filed subject to the following modifications prior to confirmation: N/A

2. Debtor(s) shall make payments to the Trustee as follows: $650.00 EACH 2ND FOR APPROXIMATELY 36 MONTHS AS TO PAY 100% for a period of not to exceed 36 months.

3. The Debtor(s) of his/her employer shall make payments into the plan to the trustee as required by the plan as confirmed, or as hereafter modified. If the Debtor(s) doe/does not cause such payments to be timely made, the trustee may request that the court provide an order directing the Debtor(s) employer to make the appropriate payroll deductions and payments to the trustee or pay the Debtor(s) entire earnings and wages to the trustee as allowed by Section 1325(b) of the Code. Such an order may be issued without further notice.

4. The Standing Chapter 13 Trustee, Lawrence J. Loheit, shall:

a. Keep detailed record of all receipts including the source or other identification of each receipt and of all disbursements (Rule 13-208(2)); and

b. File with the court, or if applicable, with the entity providing addressing for the court and the Trustee. (Rule 13208(3)) notices of creditors addresses delivered to the trustee pursuant to Rule 13-208(c); and

c. Deposit all funds received by him under the Plan with an entity which provides insurance, guarantees or deposits in the manner prescribed by 11 U.S.C. 345, and make distribution thereof in the manner provided by Rule 13-603(b).

5. Pursuant to Rule 13-309 and 11 U.S.C. 1326 the order of payment, unless other wise directed, shall be:

a. Any unpaid claim of the kind specified in 11 U.S.C. 507(a)(1);

b. The percentage fee fixed by this court for the trustee pursuant to 11 U.S.C. 1302(e);

c. Creditors whose claim are timely filed and allowed in such amounts and order of preference as may be provided by the plan or as may be required to provide adequate protection of the interest of any entity with an interest in the property of the estate or of the property of the Debtor(s).

6. The trustee shall at least once each six (6) months file with the court a report showing the funds received and disbursements made by him since the date of the last report, and shall upon the completion of the plan, file with the court a final report and accounting containing or incorporating by reference a detailed statement of receipts and disbursements as required by Rule 13-208(5).

8. Ninety (90) day after the final distribution, the trustee shall stop payments of all checks then unpaid and shall file with the clerk of the court a list of the names and addresses, so far as is known of the persons entitled to such payments and the amounts thereof. The unclaimed funds shall thereupon be deposited in the registry of the United States District Court and may be withdrawn as provided in 28 U.S.C. 2042.

9. Debtor's real property shall revest in the debtor at such time as discharge is granted or the case is dismissed.

10. Interest shall be paid to all creditors secured by personal property at the contract rate or 10% whichever is less. No interest shall be paid to creditors served by real property except as required by the promissory notes held by such creditors.

ALLOWANCE OF ATTORNEY'S FEES

The application by the attorney for the Debtor(s) for the allowance of reasonable compensation as authorized by 11 U.S.C. 330, having been considered, a reasonable fee for the services performed and undertaken by such attorney is $775.00 of which $350.00 was paid to such attorney prior to the filing of the petition initiating this proceeding. The balance such fee, $425.00 shall be paid by the trustee from the monies received under the Debtor(s) plan, provided however, that such payments shall be deferred in time to payments, if any, which may be required to provide adequate protection of the interest of the holders of secured claims.

Given this _____ day

of _____ at _____
_____, California.

/s/_____
LOREN S. DAHL
Chief Bankruptcy Judge

APPENDIX D

UNITED STATES BANKRUPTCY COURT

FOR THE EASTERN DISTRICT OF CALIFORNIA

SACRAMENTO, CALIFORNIA

EMILIO/CYNTHIA LAGUNA	)	Bankruptcy No. 288-05581-A-13

REPORTER'S TRANSCRIPT OF PROCEEDINGS

HEARING - OBJECTIONS
TO PROPOSED CHAPTER 13 PLAN

AND CONFIRMATION THEREOF

9-30-88

Before the HONORABLE LOREN S. DAHL

8109 U.S. Courthouse
Department A
Sacramento, California

TUESDAY, OCTOBER 25, 1988
10:00 a.m.

D-1

APPEARANCES

For the Creditor:

SHEPERO(SIC)/MILES
Attorneys at Law

(Acting for Miles and Shepero (SIC))

5 Hutton Centre
Drive, #1050
Santa Ana, CA 92707

BY: STEVEN J. GREEN

For the Debtor:

LAW OFFICES OF
MAX CLINE
701 12th Street,
Ste 202
Sacramento, CA 95814
BY: SCOTT DEBE

SACRAMENTO, CALIFORNIA, TUESDAY, OCTOBER 25, 1988

HEARING - OBJECTIONS TO PROPOSED CHAPTER

13 PLAN AND CONFIRMATION THEREOF

---oOo---

THE COURT: Mr. Green?

MR. GREEN: Your Honor, this is a matter scheduled for the afternoon that we would just like to submit, if it would be possible.

MR. DEBE: Page 13, number 4, Laguna.

MR. GREEN: Steven Green, making a special appearance for Miles and Shepero (SIC), who will remain the attorneys of record.

MR. DEBE: Scott Debe, for the Debtor.

THE COURT: Why is this on in the afternoon?

MR. DEBE: It's an error, I believe, your Honor. It's an Objection to Confirmation.

MR. GREEN: I have no idea. They scheduled another one for this afternoon also.

THE COURT: Anyway, you want to submit it, Gentlemen?

MR. GREEN: We'd like to submit it on the pleadings, and also request that there be Findings of Fact and Conclusions of Law on this matter. It's anticipated there will be objections.

THE COURT: Whose objections are they?

MR. GREEN: Okay. It's the party who is the holder of the deed of trust on the property and who objected to the plan because it does not provide for post interest on it.

THE COURT: Why do you want Findings? Are you going to appeal the order?

MR. GREEN: The indication they have given me is they plan on filing an appeal if it is ruled adversely.

THE COURT: Is the Chapter 13 debtor going to appeal?

MR. DEBE: No. The creditor intends to appeal if the Court determines that interest is not payable on prepetition mortgage arrearages.

I advised them of an earlier ruling in a case we had about a month ago, and they had indicated they wanted to pursue it. For the Court's reference, the other case was Schroeder.

THE COURT: Who represents the debtor?

MR. GREEN: Miles and Shepero (SIC); I am making a special appearance — oh, the creditor is represented by Scott Debe.

THE COURT: Who represents the debtor?

MR. DEBE: Max Kline's office.

THE COURT: You are?

MR. DEBE: Yes, your Honor.

THE COURT: Well, if I am consistent in my rulings, and I don't know of any reason why I wouldn't be, I can tell you right now that you can go right ahead and the objection will be denied, and you can go ahead and prepare the Findings and Conclusions, Mr. Debe.

MR. DEBE: I would be glad to do that.

THE COURT: On behalf of the debtor.

MR. DEBE: I would be glad to do that.

THE COURT: Because I certainly an not going to be any different than I was in the last case involving the same thing.

MR. DEBE: Fine, your Honor, I understood your reasoning in that one, and I can certainly appreciate it in this case.

MR. GREEN: Your Honor, Mr. Holthus, who represents the creditor, has also asked that they be served with an order of the confirmation so that they can file a timely appeal when it is signed.

THE COURT: Well, I guess if they are one of the creditors, they will get whatever they are going to get.

MR. DEBE: We can certainly supply them with a copy, your Honor.

MR. GREEN: Thank you, your Honor.

(Whereupon the hearing concluded at 10:30 a.m.)

---oOo---

REPORTER'S CERTIFICATE)
STATE OF CALIFORNIA)
)
COUNTY OF SACRAMENTO)

I, Richard S. Clark, certify that I was the official court reporter for the proceedings named herein, and that as such reporter, I reported in verbatim shorthand writing those proceedings; that I thereafter caused my shorthand writing to be reduced to typewriting, and the pages numbered 1 through 3 herein constitute a complete, true and correct record of the proceedings:

PRESIDING OFFICER:
HONORABLE LOREN S. DAHL

CAUSE: HEARING - OBJECTIONS TO PROPOSED CHAPTER 13 PLAN AND CONFIRMATION THEREOF

DATE OF PROCEEDINGS: TUESDAY, OCTOBER 25, 1988

IN WITNESS WHEREOF, I have subscribed this certificate at Sacramento, California, on this 28th day of November 1988.

/s/_____
Richard S. Clark

APPENDIX E

11 U.S.C. § 103. Applicability of chapters

(a) Except as provided in section 1161 of this title, chapters 1, 3, and 5 of this title apply in a case under chapter 7, 11, 12, or 13 of this title.

11 U.S.C. § 506. Determination of secured status

* * *

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

* * *

11 U.S.C. § 1124. Impairment of claims or interests

Except as provided in section 1123 (a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan--

* * *

(3) provides that, on the effective date of the plan, the holder of such claim or interest receives, on account of such claim or interest, cash equal to--

(A) with respect to a claim, the allowed amount of such claim; or

(B) with respect to an interest, if applicable, the greater of--

(i) any fixed liquidation preference to which the terms of any security representing such interest entitle the holder of such interest; or

(ii) any fixed price at which the debtor, under the terms of such security, may redeem such security from such holder.

11 U.S.C. § 1129. Confirmation of plan

* * *

(b)(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured claims, the plan provides--

* * *

(i)(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest on the estate's interest in such property;

* * *

11 U.S.C. § 1322. Contents of plan

* * *

(b) Subject to subsections (a) and (c) of this section, the plan may--

* * *

(2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

(3) provide for the curing or waiving of any default;

* * *

(5) notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due;

* * *

(c) The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years. Pub.L. 95-

598, Nov 6, 1978, 92 Stat. 2648; Pub.L. 98-355, Title III, §§ 316, 528, July 10, 1984, 98 Stat. 356, 389.

11 U.S.C. § 1325. Confirmation of plan

(a) Except as provided in subsection (b), the court shall confirm a plan if--

* * *

(4) the value, as of the effective date of the plan, or property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

(5) with respect to each allowed secured claim provided for by the plan--

(A) the holder of such claim has accepted the plan;

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim;.

APPENDIX F

UNITED STATES CONSTITUTION

Fifth Amendment:

> No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.
> U.S. Const. amend. V.